Europeans striving to shore up rescue fund

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Hopes for bold action push up stock indexes across the Continent

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Wedged between impatient financial markets and restive voters, European political leaders struggled Monday to formulate a bolder response to the sovereign debt crisis that might include expanding the firepower of the euro zone's bailout fund.

European officials said a plan was in the works that would enlarge the bailout fund's borrowing power but not the amount of money that countries were contributing. The proposal was met guardedly by German officials, who are struggling to swing public opinion in favor of the more modest aid plan they agreed to in July — never mind any new initiatives.

As finance ministers and central bankers trickled back to Europe from meetings in Washington over the weekend, markets were clearly eager for a plan that would isolate Greece's problems from the rest of the Continent and ensure that Italy and Spain do not also fall victim to the debt crisis.

Major stock indexes in Europe rose Monday, in part because of expectations that a more robust response to the problem was in the works.

A more potent bailout fund would not remove the need for other changes, like strengthening the banking system and improving decision making by the European Union, said Nicolas Véron, a senior fellow at Bruegel, a research organization in Brussels. But it would help, he said.

"I don't think one measure can solve it all but it would make a significant difference in market sentiment," said Mr. Véron, who testified last week before the U.S. Senate Banking Committee on the debt crisis.

Meanwhile, Finland appeared to be

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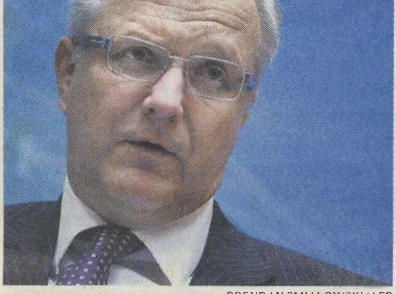

BRENDAN SMIALOWSKI/AFP

Olli Rehn, European commissioner for economic and monetary affairs, has confirmed efforts to bolster the bailout program.

STOCKS RISE ON HOPES FOR NEW TALKS
Markets in Europe rallied Monday, helped by news of talks to consider a stronger response to the crisis. *PAGE 16*

EURO VOTE A LITMUS TEST FOR MERKEL
Angela Merkel's authority to govern Germany is at stake in a vote this week, Judy Dempsey writes. *PAGE 2*

European officials strive to beef up rescue fund

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closer to resolving an impasse that had threatened to hold up deployment of the existing bailout fund. Alexander Stubb, the Finnish minister for European affairs, said the country's Parliament was likely to approve a plan agreed to by leaders in July.

Finland is also close to resolving a dispute about its demand for collateral in return for granting more aid to Greece. The dispute illustrated how political opposition in just one of the 17 euro members can block initiatives.

"I'm very confident we will get the package through Parliament," Mr. Stubb said by telephone. He declined to give details of how the collateral dispute would be resolved.

In Brussels, Amadeu Altafaj Tardio, a spokesman for the European Commission, confirmed that discussions were under way on methods to extend the effectiveness of the bailout fund, called the European Financial Stability Facility, or E.F.S.F.

Olli Rehn, the commissioner for economic and monetary affairs, had made clear at meetings in Washington that the euro zone was "contemplating further leveraging of the E.F.S.F.," Mr. Altafaj Tardio said. That option has been urged by U.S. officials.

Separately, leaders tried to quash rumors that Greece and its creditors had discussed the possibility of banks' taking a larger cut in the value of their Greek bond holdings — perhaps as much as 50 percent — to reduce the government's onerous debt burden to a more manageable level.

Such a move remained highly controversial and was opposed by the large banks as well as the European Central Bank, which owns Greek bonds with a value estimated at as much as €60 billion, or $80.8 billion. Any Greek default would probably also require a coordinated bailout of banks with large holdings of Greek debt.

As has often been the case, European leaders seemed to have different perceptions of what was being discussed and how likely it was that the proposals would find support.

A spokesman for the German Finance Ministry, Martin Kotthaus, said in Berlin there was no need to expand the size of the bailout fund by giving it more money than already agreed. There is fear that pumping more money into the fund might threaten the credit rating of countries like France by increasing their liabilities.

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Evangelos Venizelos, the Greek finance minister, said that a plan to swap some bonds for new, longer-term securities remained on track.

Markets are eager for a plan to isolate Greece's problems from the rest of the Continent and ensure that Italy and Spain do not also fall victim.

But German officials did not appear to be opposed to increasing the rescue fund's power to leverage its government guarantees. They simply wanted to avoid any discussion until Parliament votes this week on a proposal to expand the size of the fund to €780 billion. That plan was agreed to by European leaders on July 21. Some analysts have said that the fund needs to be two or three times as big to convince markets that it could handle a wider crisis.

On Monday, a senior official in the Greek Finance Ministry, responding to persistent default rumors, said no such event was imminent. And on Sunday, Evangelos Venizelos, the Greek finance minister, said in Washington that the government's plan to exchange some existing bonds for new, longer-term securities remained on track.

The debt exchange would impose a relatively modest 21 percent loss on the face value of the affected bonds. It is regarded as a good deal for investors because they would get more solid paper in exchange. Greek creditors must still indicate their willingness to participate.

Charles H. Dallara, the managing director for the Institute of International Finance, which represents the world's largest financial firms, said the international community was still examining solutions for Europe's sovereign debt crisis, but a write-down of as much as 50 percent of Greek government debt was not currently being put forward.

"The key focus right now is for governments to implement the deal struck on July 21 by mid-October, and for the Greeks to realign their policy commitments," said Mr. Dallara, who played a main role in negotiating the debt exchange. The measures could help reduce Greece's mountain of debt — now at 180 percent of gross domestic product — by as much as €20 billion, he said.

Policy makers want to put Greece on a path toward reducing its debt load to just under 100 percent of G.D.P. within this decade so that it can wean itself off taxpayer bailouts. The hope is that much of that reduction would come through revived economic growth.

But those prospects seem distant given the deep recession into which Greece has fallen, and stricter belt-tightening measures being demanded by international creditors.

Chancellor Angela Merkel of Germany rejected the idea of a Greek default, telling a television interviewer late Sunday that it could create a shock to the financial system similar to the collapse of the U.S. investment firm Lehman Brothers in 2008.

"We can only take steps that we can really control," she said on ARD, a public broadcaster. If Greece touched off another major financial crisis, she said, "then we politicians will be held responsible."

Under one option being discussed, the bailout fund would be able to absorb losses sustained by the E.C.B. on its purchases of Greek and other government bonds, according to an E.U. official not authorized to speak publicly.

There is, one official said, no preferred model and it remained unclear whether such moves would be possible without further legal changes. Some officials say they believe such steps could be constitutionally difficult, particularly in Germany.

"Further enhancement could require treaty reform," said the E.U. official, speaking on condition of anonymity, citing the sensitivity of the issue.

Resistance to new plans to strengthen the rescue fund might also be forthcoming from the E.C.B., which has been trying to reduce its bond-buying program.

Nevertheless, the tone of the debate appears to have shifted since talks in Wroclaw, Poland, this month, attended by the U.S. Treasury secretary, Timothy F. Geithner. At those discussions, Jean-Claude Juncker, who heads the group of euro zone finance ministers, said there were no reason to discuss the powers of the rescue fund with nonmembers of the euro zone.

In Washington Mr. Geithner had been "more positive and constructive than some euro zone ministers," said the E.U. official not authorized to speak publicly.

Attention will also focus this week on Greece and negotiations on the release of the next portion of international aid, worth €8 billion. Without the funds, Greece would default next month.

A mission by officials of the European Commission, the E.C.B. and the International Monetary Fund was expected to leave for Athens this week. Mr. Altafaj Tardio said that a decision on the release of the next aid installment was not expected by the time euro zone finance ministers meet next Monday.

Opposition to more aid to Greece remains deep in Germany, not only among the public but also mainstream economists and the president of the German central bank, Jens Weidmann.

Speaking in Washington on Monday, Mr. Weidmann said that aid had already weakened incentives for countries to behave responsibly.

"Contrary to what is actually needed in order to overcome the sovereign debt crisis, we risk seeing the propensity for excessive deficits rise even further in the future," Mr. Weidmann said.

Stephen Castle reported from Brussels. Liz Alderman in Paris and Landon Thomas Jr. in London contributed reporting.